

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
KEYBOARD()MNS CARDS & GIFTS, INC. D/B/A HALLMARK CARDS & GIFTS	:	DETERMINATION
:		
KEYBOARD()for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period May 1, 1979 through October 31, 1986.	:	

KEYBOARD()Petitioner, MNS Cards & Gifts, Inc. d/b/a Hallmark Cards & Gifts, c/o Barry P. Fox, Leeds & Fox, 25 West 43rd Street, New York, New York 10036, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period May 1, 1979 through October 31, 1986 (File No. 807119).

A hearing was held before Nigel G. Wright, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on May 10, 1990 at 9:15 A.M. Petitioner appeared by Barry P. Fox. The Division of Taxation appeared by William F. Collins, Esq. (Carroll R. Jenkins, Esq., of counsel).

ISSUES

- I. Whether a determination of sales tax due, as recomputed by a conciliation conferee, using a markup of 61.55% is valid when the basis of that markup is not in evidence.
- II. Whether an extension of an audit period to an earlier period without asking for the books and records of that period is valid.
- III. Whether penalties asserted under Tax Law § 1145 against a bulk sale purchaser are valid.

IV. Whether an alleged persistent failure of the Division of Taxation to timely meet its obligation to notify bulk sale purchasers of sales tax due justifies the failure of petitioner in this case to notify the Division of the bulk sale in the first place.

FINDINGS OF FACT

(a) On October 14, 1986 petitioner, MNS Cards & Gifts, Inc., purchased, through a broker, a card and gift shop located at 22 John Street, New York, New York from Fourteen Wellington Corporation ("Wellington"). The purchase price was \$310,000.00 (with a downpayment of \$70,230.76 and notes due thereafter at about two a month until January 15, 1992). The fixtures and equipment were valued at \$5,000.00.

(b) No notice of bulk sale was filed with the Division of Taxation.

(a) Fourteen Wellington Corporation, 22 John Street, New York, New York, was not registered as a vendor prior to February 1986 when a request from the Division of Taxation prompted it to register. Its only officer and stockholder was Francis M. Owens of 14 Wellington Place, Westwood, New Jersey. He is now deceased.

(b) Fourteen Wellington Corporation had been formed in September 1983. Previously, the premises were being used, apparently also as a card and gift shop, by Sixth Avenue Card Shop, Inc., also owned by Francis M. Owens and had been so used, according to Division of Taxation withholding records, since May 1979.

(a) Prior to the sale to petitioner, Fourteen Wellington Corporation had filed and paid sales taxes only for the periods ending February 28, 1986 and May 31, 1986. These were paid in June and July 1986 and totalled \$6,699.47.

(b) After the sale to petitioner, Fourteen Wellington Corporation filed sales tax returns for the remaining quarters of the audit period. These were filed in November 1986, February

1987 and May 1987.

(c) The tax returns show gross sales of \$957,860.00, taxable sales of \$899,273.00 and tax paid of \$74,190.04.

(d) The Sales Tax Master File of the Division of Taxation shows postings for each quarter of the audit period except for the quarter ended November 30, 1984. (The postings for the quarters ending February, May and August 1986 do not agree with the returns in the record.) These postings show (excluding the quarter ended November 30, 1984) gross sales of \$775,977.00, taxable sales of \$732,297.00 and tax paid of \$62,780.71. For the quarter ending November 30, 1984, the gross and taxable sales shown on the returns were \$73,581.00 and \$69,282.00. When these are added into the amounts for the other quarters, the gross sales are \$849,058.00 and the taxable sales are \$801,579.00.

(a) A request by the Division of Taxation on audit to examine the records of Wellington from September 1983 to date was made by letter dated September 16, 1986.

(b) Wellington produced certain purchase records, but nothing else.

(c) When the auditor was in the store, the store used cash registers which produced tapes. These tapes were not used in the audit.

(d) No request was made for books and records of Sixth Avenue Card Shop.

The accountant for Fourteen Wellington Corporation, Mr. Thomas Murray, estimated purchases for the period September 1, 1983 to August 1986 to be \$735,428.50.

(a) According to a copy of a single page of a publication, stated in the auditor's report and in his testimony to be published by Dun and Bradstreet, the cost of operation of "other retail stores" of less than \$100,000.00 in assets is estimated to be 61.7% of receipts. Based upon the cost of operations of 61.7%, the sales would be 61.55% higher. This percentage was not used by

the auditor in estimating taxable sales.

(b) The volume from which this single page was taken was not placed in evidence. A request to the attorney for the Division of Taxation to produce that volume has not been honored.

(a) For the period September 1, 1983 through August 31, 1986 (when Fourteen Wellington Corporation operated the business), the auditor deemed that the sales figure of \$775,477.00 shown on the late-filed returns was actually a purchase figure. This figure was then increased by a 50% markup (this was the same as increasing purchases by 58%). The result came to \$1,163,215.50. To this he added \$104,760.00 representing gross sales for the period ending November 30, 1984 (for which a return was not filed). This figure is the average of the preceding four quarters. The resulting gross sales, totalling \$1,267,976.00, were subjected to tax at 8.25% of \$104,608.03. From this the auditor subtracted the taxes of \$6,699.47 paid before the bulk sale to arrive at a tax due for petitioner of \$97,908.56. To this was added \$412.50 for the period ending October 31, 1986 representing the sales tax due on the \$5,000.00 bulk sale of fixtures for a total of \$98,321.06.

(b) The determinations for the periods May 1, 1979 through August 31, 1983 were arrived at by projection from certain figures for 1984 as already determined. The audited gross sales for the quarters ending February 29, 1984, May 31, 1984, August 31, 1984 and November 30, 1984 (this quarter being an average of the preceding four quarters) were assigned to the corresponding quarters of the earlier years. These figures were then discounted for inflation by use of an annual average index figure of the U.S. Bureau of Labor Statistics, Consumer Price Index for urban wage earners for New York and Northeastern New Jersey. The index numbers found were 295.1 for 1984, 285 for 1983, 274.1 for 1982, 259.9 for 1981, 236.8 for 1980, and 212.8 for 1979. These discounts were computed to be 96% for 1983, 92% for

1982, 86% for 1981, 75% for 1980 and 60% for 1979. (These computations are slightly wrong and were corrected in a redetermination made after a conciliation conference.) The adjusted gross sales thus arrived at totalled \$1,758,323.00. The tax due thereon (at 8% to August 31, 1981 and 8.25% thereafter) came to \$142,917.00, with \$105,195.00 for the quarters prior to August 31, 1982 and \$37,722.00 for the quarters thereafter.

(c) An omnibus penalty was computed at 10% of the computed tax due from Fourteen Wellington Corporation for the periods involved and not on the higher amounts due from petitioner. Fourteen Wellington Corporation had received credit for the taxes paid after the bulk sales and before the dates of the notices, as well as the taxes paid for February and May 1986.

On July 27, 1987, four notices of determination and demands for payment of sales and use taxes due were issued to petitioner. These notices were for the following amounts:

(a) for the period May 1, 1979 through August 31, 1982 for tax due of \$105,195.00, penalty under Tax Law § 1145(a) of \$26,298.75 and interest of \$114,012.78, for a total amount due of \$245,506.53;

(b) for the period September 1, 1982 through August 31, 1983 for tax due of \$37,722.00, plus penalty under Tax Law § 1145(a) of \$9,430.50 and interest of \$24,960.30, for a total amount due of \$72,112.80;

(c) for the period September 1, 1983 through October 31, 1986 for tax due of \$98,321.06, plus penalty under Tax Law § 1145(a) of \$24,954.64 and interest of \$32,789.31, for a total amount due of \$156,060.01; and

(d) for the period September 1, 1985 through August 31, 1986 for a penalty under Tax Law § 1145(c) (the "omnibus" penalty) in the amount of \$1,355.41.

On July 27, 1987, notices were also sent to Fourteen Wellington Corporation a/k/a 6th

Avenue Card Shop, Inc. a/k/a Hallmark Cards & Gifts. Also on July 27, 1987 notices were sent to Francis Owens, as officer of Fourteen Wellington Corporation.

At a conference, the determinations of tax due were reduced as follows: from \$105,195.00 by \$9,828.21 to \$95,366.79; from \$37,722.00 by \$4,075.16 to \$33,646.84; from \$98,321.06 by \$27,158.96 to \$71,162.10; and from \$1,355.41 by \$574.56 to \$780.85.

(a) The conciliation conferee recomputed the tax for the period September 1, 1983 to August 31, 1986. He began with the taxable sales posted in the Division of Taxation's file of \$732,297.00 and added the amount of \$69,286.00 shown on the return for the quarter not posted, November 30, 1984 (see Finding paragraph 3[d]), for a total of \$801,579.00 and multiplied this by an error rate of 35.38%. The error rate was computed by comparing such reported taxable sales with an audited taxable sales figure derived from a list of purchases for the period supplied by Wellington's accountant. These purchases totalled \$735,428.50. The conferee reduced this by \$50,000.00 to allow for an increase in inventory over the period. He then allowed a 2% pilferage rate to arrive at a figure of \$671,719.93. To this he applied a markup of 61.55%. This markup was derived from figures for the cost of operations of corporations with and without income for "other retail stores" which, according to the audit report and the auditor's testimony, was compiled by Dun and Bradstreet. (After the hearing, the auditor, in an ex parte communication, revealed the data comes from a different source: the "Almanac of Business and Industrial Financial Ratio" by Leo Troy.) Those figures showed that the cost of operations was 61.9% of total receipts (this is equivalent to the receipts being 161.55% of the cost of operations). This markup applied to the audited purchases resulted in audited sales of \$1,085,163.55, which is 135.38% of the taxable sales of \$801,579.00. This resulted in total tax due of \$89,522.17. The tax paid with the late-filed returns was \$62,780.71. Wellington, the vendor was given credit for

this entire amount so its additional tax was \$26,746.46. MNS, the purchaser and the petitioner herein was given credit only for the payments made prior to the purchase. These were for the quarters ending November 30, 1985 and February 28, 1986 and was in the amounts, respectively, of \$5,406.14 and \$3,913.47, for a total of \$9,319.61. The resulting tax due from petitioner was therefore \$80,207.56.

(b) The determination for the period May 1, 1979 through August 31, 1983 was arrived at by projection of the figures for 1984. The adjusted gross sales for the quarters ending February 28, 1984, May 31, 1984, August 31, 1984 and November 30, 1984 (this quarter being an average of the preceding four quarters) were assigned to the corresponding quarters of the earlier years. These figures were then discounted for inflation. The index numbers used were the same as used in the audit. The discounts were computed to be 96.58 for 1983, 92.88 for 1982, 88.07 for 1981, 86.74 for 1980 and 67 for 1979. These are slightly less favorable to petitioner than those calculated by the auditor. The adjusted taxable sales thus arrived at totalled \$1,587,705.20. A tax on this was computed to be \$129,013.63. This is \$95,366.79 for the period May 1, 1979 through August 31, 1982 and \$33,646.84 for the period September 1, 1982 through August 31, 1983.

(c) The determination of the omnibus penalty was computed as 10% of the tax due, as before, from Fourteen Wellington Corporation for the relevant periods and not on the higher tax due from petitioner.

Petitioner's assertions that the Division of Taxation is always delinquent in meeting its obligations under Tax Law § 1141(c) to give notice of tax due to bulk sale purchasers is unsupported by any evidence whatsoever. Petitioner does not cite any actual cases where it asserts this has happened.

CONCLUSIONS OF LAW

A. The audit cannot be accepted as valid. The critical element in this sales tax audit case is the amount of the markup (61.55%) applied to the purchases declared by the business in question (see paragraph "11[a]"). That amount was repeatedly stated in the workpapers and at the hearing to be derived from a publication of Dun and Bradstreet. That publication has not been produced for introduction into evidence or even for inspection by petitioner and the administrative law judge. I cannot tell from the single page produced how the figures were computed or their limitations. In particular, in this case, I have no knowledge that "other retail stores" as described by that publication is the proper category of that publication to cover the business here in question. It now appears that the figures were not from Dun and Bradstreet at all. The fact that the auditor had incorrectly identified the source of his figures of course accentuates the need that the original volumes be produced for inspection at the hearing. I cannot for these reasons accept the figure of 61.55% offered as a markup.

B. Of course, the original audit in this case was based on a markup of 50%. Even if the validity of that was argued at the hearing (and it was not argued), I would have to reject that computation too. This markup audit was based upon the application of the markup to a sales figure which was "deemed" to be a purchase figure (see paragraph "7[a]"). Of course, this is wholly arbitrary. Furthermore, the only basis for the amount of markup identified in the testimony was the Dun and Bradstreet report which I have found invalid. The only other basis for this markup which I could infer from the testimony would be the experience of the auditor. Such a rationale, however, has been ruled speculative and irrational (Matter of Grecian Square, Inc. v. State Tax Commission, 119 AD2d 948; Matter of Oxford Associates, 209 F Supp 242; Matter of William Savino d/b/a William Service Station, Tax Appeals Tribunal, September 22,

1988). Without either a rationale for the use of the sales figure as a purchase figure or a rationale for the markup, of course, the computation of tax is incomplete and the audit is based on a principle which is fundamentally erroneous and must be rejected (Matter of Roncone, State Tax Commission, March 11, 1986, TSB-H-86[83]S; Matter of King Crab, Inc. v. Chu, 134 AD2d 51).

C. The amount attributable to the \$5,000 bulk sale of fixtures (Finding of Fact "7[a]") was not contested at hearing by Petitioner and is therefore sustained.

D. The other issues raised herein need not be addressed.

E. The petition of MNS Cards & Gifts, Inc. is granted to the extent indicated in Conclusions of Law "A" and "B". The notices of determination and demand for payment of sales and use taxes due dated July 27, 1987 and numbered S870727005Q, S870727006Q and S870727012Q are cancelled. The notice of determination and demand for payment of sales and use taxes due dated July 27, 1987 and numbered S870727007Q is sustained to the extent indicated in Conclusion of Law "C" but is cancelled in all other respects.

DATED: Troy, New York

1/17/91

ADMINISTRATIVE LAW JUDGE